No. 95-105

Supreme Court, U.S.
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

AMERICAN MUTUAL LIFE INSURANCE COMPANY AND SUBSIDIARIES,
Petitioner,
v.
UNITED STATES,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF *AMICI CURIAE* OF ALLMERICA FINANCIAL CORPORATION, THE AMERICAN HOME LIFE INSURANCE COMPANY, AMERITAS LIFE INSURANCE CORPORATION, BALTIMORE LIFE INSURANCE COMPANY, BOSTON MUTUAL LIFE INSURANCE COMPANY, CENTRAL STATES HEALTH & LIFE COMPANY OF OMAHA, CENTURY LIFE OF AMERICA, FARMERS & TRADERS LIFE INSURANCE COMPANY, GOVERNMENT PERSONNEL MUTUAL LIFE INSURANCE COMPANY, GUARANTEE MUTUAL LIFE COMPANY, THE HOMESTEADERS LIFE COMPANY, ILLINOIS MUTUAL LIFE AND CASUALTY COMPANY, INDIANAPOLIS LIFE INSURANCE COMPANY, JOHN HANCOCK MUTUAL LIFE

(*Amici Curiae Continued on Inside Cover*)

IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Should § 809 of the Internal Revenue Code, which imputes income to mutual life insurance companies according to a formula that compares one time period with another, be interpreted to alter the formula's results in tax years when those results favor the taxpayer—thus vastly increasing the tax liability of mutual companies relative to stock companies?

STATEMENT PURSUANT TO RULE 29.1

Amici except as noted have no parent companies and no subsidiaries other than wholly-owned subsidiaries and those with no public ownership. Union Central Life Insurance Company owns 73% of the shares of The Manhattan Life Insurance Company, the remaining shares of which are publicly traded. Physicians Life Insurance Company is a wholly owned subsidiary of Physicians Mutual Life Insurance Company. Illinois Mutual Life and Casualty Company has a publicly traded subsidiary, Morton Federal Savings Bank, FSB. Pacific Mutual Life Insurance Company has an ownership interest in PIMCO Advisors L.P., a publicly traded company. Allmerica Financial Corporation a subsidiary of State Mutual Life Insurance Company, owns shares in two publicly traded subsidiaries, Citizens and SMA Financial Corporation. Allmerica after conversion to stock ownership will be known as First Allmerica Financial Life Insurance Company. Century Life of America is owned by Century Companies of America, an affiliate of CUNA Mutual Insurance Group.

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OCTOBER TERM, 1995

No. 95-105

AMERICAN MUTUAL LIFE INSURANCE COMPANY AND SUBSIDIARIES,

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v.

UNITED STATES,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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BRIEF *AMICI CURIAE* OF ALLMERICA FINANCIAL CORPORATION, *et al.*, IN SUPPORT OF PETITIONER

INTEREST OF THE *AMICI*

Amici are thirty-nine mutual life insurance companies located throughout the United States. The federal tax liability of each for 1987 and several later years, amounting for the industry to billions of dollars, depends on the interpretation of § 809 of the Internal Revenue Code announced by the Eighth Circuit in this case. The Government repeatedly emphasized to the Court of Appeals

> "the importance of the issue presented, which arises with respect to *all* mutual companies." [1]

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[1] Brief for the Appellant, No. 94-1440, U.S.C.A., Eighth Cir., at i (emphasis in original) (hereinafter "Government's Brief"); see also *id.* at 33 n.10. Twenty-four mutual life insurance companies, 15 of them signatories to this brief, are located in the Eighth Circuit.

The decision also creates a major new competitive disadvantage for *amici* with respect to the stock insurance companies with which they compete, and may force some of *amici* to abandon the mutual policyholder form of ownership and reorganize instead as stock companies.

Pursuant to this Court's Rule 37.2, petitioner and respondent have consented to the filing of this brief.

STATEMENT

Amici adopt the statement of the case set forth in the petition for certiorari. *Amici* underscore the following aspects of the record:

1. Until this case reached the Court of Appeals, the Government conceded in this litigation that the formula specified in § 809, which compares one time period with another, occasionally will result in a negative number.[2] A negative number occurred here because, as a result of annual fluctuations in the earnings of all insurance companies, the average returns of mutuals in 1986 exceeded the average for stock companies in 1983-85. The IRS duly published an announcement of this negative number, for use in preparing 1987 tax returns. P. 5a, *infra*. The Government also conceded in the District Court that the number calculated pursuant to the statute was negative. P.C.A. 14a.[3]

2. The Government argued in the District Court that, although the statute contains no such proviso, the "life insurance deduction" authorized in § 805(a)(8) and calculated by § 809(f) should be limited so as not to exceed,

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[2] The District Court pointed out that "[t]he parties are in agreement that the formula contained in section 809(c)(1) and 809(f)(3) yields a 1986 recomputed differential earnings rate of −1.695 percent and, in turn, a 1986 recomputed differential earnings amount of −$1,580,476." P.C.A. 14a. (References to "P.C.A." are to the appendix to the petition for certiorari.)

[3] The Government's case in the District Court was presented by attorneys of the Tax Division of the Department of Justice.

when combined with the "policyholder dividend deduction" authorized in § 805(a)(3) and calculated under § 808 (c)(2), the policyholder dividends for that year. See P.C.A. 15a. The District Court rejected that argument because, it held, the "policyholder dividend deduction" (computed in 1986) and the "life insurance deduction" (computed in 1987) are two separate provisions. "This language of section 809(f)(2) . . . . on its face unambiguously provides for a life insurance deduction of $11,407,401," the court held. P.C.A. 15a. "[The Government's] assertion that section 808(c) [the "policyholder dividend deduction"] should be read into section 809(f)(2) [the "life insurance deduction"] . . . disregards the statutory language." P.C.A. 16a.

> "To read section 808(c) into section 809(f)(2), as [the Government] asks the court to do, would effectively rewrite the statute. It is for Congress, not the courts, to rewrite statutes." *Id.*

3. On appeal, the Government retracted its previous concession that the subtraction prescribed in § 809(c)(1) in some years will produce a negative number. The Government told the Court of Appeals that

> "[T]he Government made an erroneous legal concession during the district court proceedings. Specifically, the Government conceded (in a memorandum of law) that when the average mutual earnings rate exceeds the imputed earnings rate, 'the formula contained in section 809(c) yields a negative differential earnings rate which, in turn, yields a negative differential earnings amount.' . . . In other words, the Government conceded that the 'excess of' 16.285 over 17.980 is minus 1.695, despite the fact that this characterization is contrary to the plain meaning of the word 'excess.' As a result, *the Government* further *acknowledged that strict application of the Section 809(f) formula* (at least when considered in isolation) *supported taxpayer's position in this case.*"

Government's Brief at 29-30 (emphasis supplied).

The Government's new appellate attorneys then "develop[ed] the winning theory for the government in its victory." P. 1a, *infra*. That "winning theory" was contrary to what the Government had conceded before, not only in this litigation but in the published bulletins of the IRS.[4] But the new theory persuaded the Court of Appeals, which was repeatedly admonished by the Government that otherwise a "multibillion dollar windfall" [5] was about to occur.

The Government's new "winning theory" asserted that—in spite of the statutory formula specified in § 809(f)(2)—the recomputed differential earnings rate should not be allowed to be less than zero. That was because, the Government argued, the amount of the "life insurance deduction" along with the "policyholder dividend deduction" should not be allowed to exceed the amount of policyholder dividends for a particular year. The "life insurance deduction" of § 809(f), urged the Government, was to be downgraded to merely a technical adjustment to the prior year's "policyholder dividend deduction." The Court of Appeals entirely accepted the Government's new theory, not even mentioning that in the District Court the Government had conceded the opposite.

4. Both parties in the Court of Appeals recognized the importance and national impact of the case.[6]

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[4] From the enactment of § 809 in 1984 until this case, the Government agreed with the mutual life insurance companies that § 809's "recomputed differential earnings rate" can be a negative number. The IRS itself for use in applying § 809 published a negative "recomputed differential earning rate" of −1.7% for 1986. See Pet. Cert. 11-12; 1988-12 Int. Rev. Bull. 56, p. 5a, *infra*. The Court of Appeals pointed out that "[i]ndeed, in past years, the Internal Revenue Service acknowledged the possibility of a negative excess." P.C.A. 7a.

[5] Reply Brief for Appellant, No. 94-1440, U.S.C.A., Eighth Cir. (July 8, 1994), at 4 (hereinafter "Government's Reply Brief"); see also n. 19, *infra*.

[6] For that reason, petitioner did not object to the Government's change of position in the Court of Appeals, because "it is a con-

5. Subsequently the Government issued public praise for the skill of its appellate attorney in "developing the winning theory for the government in its victory." P. 1a, *infra*.

SUMMARY OF ARGUMENT

This is an issue of almost unprecedented financial and fiscal impact, involving every mutual life insurance company in the country, and tax claims estimated by the Government itself at over $5 billion. In addition to directing a vast transfer of money from mutual policyholders to the federal government, the result of the decision is to alter and increase dramatically the tax liability of mutual companies relative to stock life insurance companies—exactly the *opposite* of what Congress was seeking to accomplish when it enacted § 809 to try to equalize the tax treatment of the two kinds of companies. The holding here makes no economic sense, and completely skews the relative tax burdens of the two parts of the life insurance industry. It is likely to cause a massive restructuring of that industry in the United States, the shifting of funds to stock companies, and the demise of the mutual form of life insurance organization.

That staggering macroeconomic impact calls for review by this Court. This is "an important question of federal law which has not been, but should be, settled by this Court." Supreme Court Rule 10.1(c). Moreover, the Court of Appeals violated this Court's holdings on statutory and administrative interpretation when it substituted its misunderstanding of congressional intent, to replace the formula Congress explicitly enacted in the statute. And it departed from the well settled rule of *Skidmore* v. *Swift &*

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tinuing issue . . . will arise in subsequent taxable years . . . will, in addition, arise in other cases." Brief of Plaintiff-Appellee, No. 94-1440, U.S.C.A., Eighth Cir., at 22 n.15. The Government called petitioner's position "forthright[]." Government's Reply Brief at 2 n.1.

Co., 323 U.S. 134, 140 (1944), and instead accorded "great deference," P.C.A. 8a, to an IRS regulation adopted *after* the District Court's decision, a regulation that altered the agency's previously published contrary position.

ARGUMENT IN SUPPORT OF CERTIORARI

I. THE ISSUE AFFECTS EVERY MUTUAL LIFE INSURANCE COMPANY IN THE UNITED STATES.

There are more than 100 mutual life insurance companies in the United States, with tens of millions of policyholders. Every one of those companies, and every one of those policyholders, is affected by the Court of Appeals' misconstruction of § 809. The lengthy array of companies that have joined in this brief reflects the across-the-board importance of the issue. Affected also, indirectly but in very real terms, are the country's stock insurance companies, which are granted an enormous competitive advantage over mutuals by the ruling of the Court of Appeals here.[7] *Cf. United States* v. *American Bar Endowment*, 477 U.S. 105, 114 (1986) (pointing out that "the effective cost of ABE's insurance will be lower than the cost of competing policies that do not offer tax benefits").[8]

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[7] Responding at oral argument to the question "why would the stock companies be interested?," government counsel explained, Tr. of Oral Arg., Eighth Cir., at 13-14:

> "Because anything that affects the taxes of one in a competitive industry, affects the costs of one, would affect the other. If one side is paying lower taxes, then they have a competitive advantage."

[8] See also Reply Brief for the United States, *United States* v. *American College of Physicians*, No. 84-1737 (filed June 21, 1985): "the decision below is the first by a court of appeals to consider the question presented here," but "[w]e believe that the departure from even-handed administration of the tax laws required by the decision below is important enough—to the IRS, to Congress, and to respondent's taxpaying competitors in the marketplace—to warrant this Court's review." *Id.* at 10, 11. (Cert. granted, 473 U.S. 904 (1985).)

Ironically, it was in an effort roughly to equalize the tax treatment of stock and mutual life insurance companies that Congress enacted § 809 in the first place. See, *e.g.*, H.R. Rep. No. 98-432, 98th Cong., 2d Sess., Pt. II at 1422 (1984). The sponsors repeatedly explained that they wanted the tax code to treat stock and mutual companies alike, to "level that playing field."[9] The perverse result here, now embodied in a *post hoc* interpretive regulation the Court of Appeals also approved, turns out to be just the opposite of what Congress had in mind.[10] The decision imposes on the mutual companies a vast burden of $5 billion additional taxes—a burden that ultimately will fall on the tens of millions of mutual policyholders in the form of reduced dividends or increased premiums.

Apart from the sheer cost to mutual companies and their policyholders, the ruling below will likely alter the insurance industry. Stock companies already enjoy a number of advantages, such as access to capital markets, that are denied to mutuals. As a result, since 1984 15 mutual life insurance companies have ceased to be mutuals and have converted to stock ownership.[11]

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[9] *Tax Treatment of Life Insurance*, Hearings Before Subcomm. on Select Revenue Measures, House Comm. on Ways and Means, 98th Cong., 1st Sess. 76 (1983) (Chairman Stark); see additional citations at Pet. Cert. 23 n.8.

[10] *Cf. Portland Golf Club* v. *Commissioner*, 497 U.S. 154, 165 (1990) ("[t]o allow such an offset . . . would run counter to the principle of tax neutrality which underlies the statutory scheme"). *Cf. also* Brief for the United States, *United States* v. *American College of Physicians*, No. 84-1737 (filed Sept. 14, 1985), at 11 ("the decision below flouts Congress's design to achieve parity of tax treatment between exempt and non-exempt entities"); [Government's] Petition for Certiorari, *United States* v. *Hill*, No. 91-1421, at 14 (filed March 6, 1992): "The fiscal consequences of the decision in this case are enormous. . . . It enhances the perceived unfairness of the Code that Congress sought to remedy." (Cert. granted, 503 U.S. 1004 (1992).)

[11] *Amicus* Midland Life Insurance Company recently converted to stock ownership, and *amici* Allmerica Financial Corporation and Guarantee Mutual Life Company have obtained approval to do so.

That trend can be turned into a stampede by this ruling. Economists and other observers may differ as to whether such a restructuring of the insurance industry is a good thing. Surely none can deny that it will be a momentous change in a major segment of the United States economy. For such an alteration of American business to be provoked by a highly questionable reading of a tax provision—a provision that was intended to minimize rather than exacerbate the tax differences between the two forms of insurance ownership—is a consequence too far-reaching to go unreviewed by this Court. *Cf., e.g., NationsBank, N.A.* v. *Variable Annuity Life Ins. Co.*, 115 S. Ct. 810 (1995) (certiorari granted to decide whether certain national banks are barred from competing with insurance companies in selling annuities); *United States* v. *Atlas Life Ins. Co.*, 381 U.S. 233, 239 (1965) ("[w]e granted certiorari to consider this important question relating to the taxation of life insurance companies"); *Commissioner* v. *Lincoln Sav. & Loan Ass'n*, 403 U.S. 345, 346-47 (1971) ("[b]ecause of the importance of the issue for the savings and loan industry and for the Government, we granted certiorari").[12]

II. THE SUM AT ISSUE IS GARGANTUAN.

The amount of tax that depends on the interpretation given § 809 exceeds $5 billion. That figure is so large that it is actually a significant fraction of the total revenue the federal government collects in corporate income taxes. In asking for reversal, the Government admonished the Court of Appeals:

> "At the outset, it [is] worth establishing what this issue involves. The issue presented here arises with

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[12] *Cf.* also [Government's] Petition for Certiorari, *FERC* v. *United Distribution Cos.*, No. 89-1453 (filed March 15, 1990), at 16 ("If allowed to stand, the decision will cause substantial disruption in the natural gas industry . . . .") (cert. granted, 496 U.S. 904 (1990)); Brief for the United States, *United States* v. *American College of Physicians, supra*, at 41 ("The decision below . . . has repercussions far beyond the tax revenue at stake").

> respect to *all* mutual life insurance companies. The issue has arisen in 1986 (the base year involved in this case), 1989, and 1991, and also (based on the IRS's tentative computation) has arisen in 1992. . . . The Internal Revenue Service has estimated that the invalidation of Treas. Reg. § 1.809-9 would result in a revenue loss of almost $2 billion for 1986, 1989 and 1991 alone."

Government's Reply Brief at 3 (emphasis in original). Subsequently the Government increased its estimate of the stakes to $5 billion, announcing in a press release that its appellate attorney's

> "handling of a life insurance case helped save the U.S. Treasury five billion dollars."

Department of Justice Press Release No. 93-355 (June 22, 1995), p. 1a, *infra*.

This Court on appropriate occasions has granted certiorari to review decisions interpreting federal statutes in which the sums at stake are extraordinarily large—though rarely approaching the $5 billion at issue here. See, *e.g.*, *United States* v. *Mitchell*, 463 U.S. 206, 211 n.7 (1983) ("the damages claimed in this suit alone may amount to $100 million"); *Commissioner* v. *Standard Life & Accident Ins. Co.*, 433 U.S. 148, 151 n.5 (1977) ("[w]e are informed that substantially more than $100 million is in dispute"); see also *Mobil Oil Exploration & Producing Southeast, Inc.* v. *United Distribution Cos.*, 498 U.S. 211, 213 (1991) ("[i]n light of the economic interests at stake, we granted certiorari").[13]

It is quite understandable that the Government would like an additional $5 billion in revenues. But the federal

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[13] See also [Government's] Petition for Certiorari, *United States* v. *Atlas Life Ins. Co.*, No. 489, OT 1964 (filed Sept. 11, 1964): "regarded as a 'test case' by the life insurance industry . . . will subject the government to . . . claims for refund of approximately $400,000,000 . . . . Staggering amounts of revenue turn upon the issue." *Id.* at 11, 16. (Cert. granted, 379 U.S. 927 (1964).)

government's fiscal situation does not provide reason for misapplying the Internal Revenue Code. On the contrary, it is a compelling reason for granting certiorari to resolve the matter. See *United States* v. *Hill*, 113 S. Ct. 941, 945 (1993) ("[b]ecause of the importance of the issue to the federal fisc, we granted certiorari"); *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132, 138 (1989) ("[t]o clarify the operation of the § 902 credit in the tax years to which it applies, we granted certiorari"); *Harrison* v. *Northern Trust Co.*, 317 U.S. 476, 478 (1943) ("[w]e granted certiorari because of the importance of the question in the administration of the federal estate tax system").[14] None of those cases involved a conflict of decisions in the lower courts, nor have a number of other cases that could be cited that raised national issues of tax law in which this Court has granted certiorari.

If the Eighth Circuit had affirmed the District Court's decision instead of reversing, there is little doubt that the Solicitor General would be petitioning this Court to grant certiorari, as the Government regularly does, without any conflict in the circuits, when major tax issues of nationwide impact are decided against it. *E.g.*, *United States* v. *Hill*, *supra*; *United States* v. *American College of Physicians*, 475 U.S. 834 (1986); *Commissioner* v. *Lincoln Sav. & Loan Ass'n*, *supra*; *United States* v. *Atlas Life Ins. Co.*, *supra*.[15] The need for decision by this Court

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[14] See also, *e.g.*, *Alaska* v. *American Can Co.*, 358 U.S. 224, 225 (1959) ("certiorari . . . was granted in view of the fiscal importance of the question to Alaska"); [Government's] Petition for Certiorari, *Commissioner* v. *Lincoln Sav. & Loan Ass'n*, No. 544 OT 1970 (filed Aug. 14, 1970), at 8: "The question presented in this case is of substantial fiscal and administrative significance." (Cert. granted, 400 U.S. 901 (1970).)

[15] In a currently pending petition, raising a question of interpretation of a tax treaty, the Government urges that "the correct disposition of this substantive question has a significant impact on the public fisc." Petition for Certiorari, *United States* v. *Xerox*

is just as great when the Government prevailed in a court of appeals, on this nationwide $5 billion issue.

III. RESOLUTION BY THIS COURT WILL AVOID USELESS LITIGATION THROUGHOUT THE COUNTRY.

There are thirty-nine mutual life insurance companies submitting this brief. Because of the statute of limitations, many of them, and other mutual companies, particularly the smaller ones, face the imminent necessity of either giving up their full § 809 life insurance deduction claims for 1987, or filing suits throughout the country exactly like petitioner's here.[16] A greater waste of resources—not

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Corp., No. 94-2005 (filed June 7, 1995), at 14. The Government adds that

> "Respondent claims . . . that the petition should be denied because there are no conflicting decisions. But we did not argue that the petition should be granted because of a conflict within the circuits."

Reply Brief for the United States, No. 94-2005 (filed Aug. 16, 1995), at 1. See also, currently pending, [Government's] Petition for Certiorari, *United States* v. *County of San Diego*, No. 95-128 (filed July 21, 1995) (issue of federal contractors' liability for state *ad valorem* taxes): "Several billions of dollars worth of federal properties are privately operated under federal management contracts in California alone. As a result, there is a significant administrative interest in the prompt resolution of the questions presented in this case." *Id.* at 14.

Last month, when a United States Court of Appeals entered a decision finding the Government liable for up to $1.5 billion to three savings and loan companies, and others similarly situated could claim $10 billion or more, the Government immediately announced that "the Justice Department plans to ask the Supreme Court to overturn" the decision "[b]ecause so much money is at stake." J. Knight, *Thrift Cleanup Costs May Soar*, Washington Post, Aug. 31, 1995, p. A1, col. 1; see *Winstar Corp.* v. *United States*, 1995 WL 509409 (Fed. Cir. 1995).

[16] The government recognized that "[t]his case . . . of course is being closely watched," "[t]here's a 100 some mutual companies," and "I'd be surprised if any company permanently gave up its right to litigate for the 86-87 years." Tr. of Oral Arg., Eighth Cir., at 16.

only the companies' but also the Government's—is difficult to imagine.

This is not the sort of issue in which a delayed review by this Court may acquire context or wisdom from awaiting different fact situations to be considered by other courts. There are no individual facts to consider. The issue, as the Government itself has repeatedly emphasized, is purely one of interpreting the national tax code. The identical issue, in the Government's words, "arises with respect to *all* mutual companies." Government's Brief, *supra*, at i (emphasis in original). There is no use in multiplying federal cases raising this inescapable tax issue for every mutual company in the country.[17]

To avoid such duplicative litigation and resolve nationwide issues of basic federal law is one reason this Court was established. See *United States* v. *Standard Oil Co.*, 332 U.S. 301, 302-03 & n.2 (1947) (certiorari granted "because of the novelty and importance of the principal question" where "the suit was also said to be representative of a number already commenced"). Indeed, this Court has previously granted certiorari without lower-court conflicts to review decisions that significantly affect the functioning of the insurance industry. *E.g.*, *United States* v. *Atlas Ins. Co.*, *supra*; *cf. NationsBank, N.A.* v. *Variable Annuity Life Ins. Co.*, *supra*. It does so for other important federal laws of national application as well. *E.g.*, *Andrus* v. *Utah*, 446 U.S. 500, 506 (1980) (certiorari to resolve "a significant issue regarding the disposition of vast amounts of public lands");

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[17] *Cf.* [Government's] Petition for Certiorari, *United States* v. *Goodyear Tire & Rubber Co.*, No. 88-1474 (filed March 8, 1989) (arguing that even though because of a subsequent amendment "the prospective impact of the decision below has been diminished somewhat," nevertheless certiorari should be granted because of "the numerous and substantial refund claims that are likely to be filed." *Id.* at 24, 26. "The decision below is of enormous importance to the public fisc . . . . massive revenue impact of the decision below." *Id.* at 22, 23.). (Cert. granted, 490 U.S. 1045 (1989).)

Southeastern Community College v. *Davis*, 442 U.S. 397, 404 (1979) ("[b]ecause of the importance of this issue to the many institutions covered by § 504, we granted certiorari"); *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 456 (1969) ("we granted certiorari because of the importance of the questions raised to the administration of the securities laws"). The list could be extended practically indefinitely.[18]

IV. THE DECISION OF THE COURT OF APPEALS IS STRIKINGLY ERRONEOUS AND RAISES ISSUES OF STATUTORY INTERPRETATION THAT THEMSELVES MERIT REVIEW.

Amici recognize that this Court does not grant certiorari simply because a lower-court decision is notably erroneous. But error surely adds weight when, as here, there are other compelling reasons for review. And in this case the error of the Court of Appeals' well-meaning but entirely superficial opinion is palpable.

A. The Court of Appeals, Believing It Was Preventing a "Windfall" to Taxpayers, Gravely Misunderstood § 809.

The Government constantly hammered to the Court of Appeals that the mutual companies were seeking a "windfall," [19] and that something must be amiss if, because of

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[18] For other examples see, *e.g.*, *Watt* v. *Western Nuclear, Inc.*, 462 U.S. 36, 42 (1983) ("[i]n view of the importance of the case to the administration of more than 33 million acres" "an issue of first impression in the federal courts"); *American Federation of Musicians* v. *Wittstein*, 379 U.S. 171, 175 (1964) ("the question being an important one of first impression under the LMRDA"); *United States* v. *Zazove*, 334 U.S. 602, 605 (1948) ("certiorari to review the important question of statutory construction involved").

[19] See, *e.g.*, Government's Reply Brief at 4 ("multibillion dollar windfall"), 8 ("windfall") (twice), 9 ("windfall"), 10 ("huge windfall tax deductions"), 11 ("windfall deductions") ("multibillion dollar windfall deduction"), 12 ("windfall") (twice). See also

the operation of § 809(f)(2), the life insurance deduction computed in 1987 turned out together with the § 808(c) policyholder dividend deduction for 1986 to exceed 1986 policyholder dividends. The Court of Appeals completely accepted the argument, opening its opinion by inaccurately announcing that "[t]he issue in this case is whether Congress intended to give mutual life insurance companies so-called dividend deductions greater than their dividends in any given year." P.C.A. 1a-2a.[20] The court's conclusion, which it described as carrying out "the purpose of the statute," was simple:

> "AMLI is not entitled to deduct an amount greater than its dividends."

P.C.A. 5a. The court unfortunately both misunderstood the purpose of the statute, and rejected the plain command of the statute's language.

1. The Court of Appeals' opinion rests on an assertion —it is no more than that—that the calculation prescribed in § 809(f)(1) and § 809(f)(2), "should," P.C.A. 7a, never result in a "life insurance deduction" and "policyholder dividend deduction" greater than policyholder dividends for the year in question. The statute does not say that. The statutory formula, which compares different years, contemplates that the opposite may occur.

Section 809(f)(2), captioned "Deduction where recomputed amount smaller," provides in full:

> "In the case of any mutual life insurance company, if—
>
> > "(A) the differential earnings amount determined under this section for any taxable year, exceeds

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Tr. of Oral Arg. 37-38 ("windfall deductions") ("pure and simple windfall") ("they would be getting a windfall").

[20] The "life insurance deduction" of § 809(f)(2) is not, of course, a "so-called dividend deduction."

> "(B) the recomputed differential earnings amount for such taxable year,
>
> such excess shall be allowed as a life insurance deduction for the succeeding taxable year."

Here there is no dispute that (A) was $9,826,925. There is no dispute that, unless the statutory formula is ignored and an artificial limit added, (B) was —$1,580,476. Unless every mathematician from Pythagoras to Einstein has been wrong, $9,826,925 exceeds —$1,580,476 by $11,407,401. That ought to be the end of the matter.

2. The Government relentlessly warned that unless the court reversed the District Court, mutual companies would receive a "windfall." No such thing. The final computation required by § 809 is not tied at all to dividends. It is simply a rough method to "impute" additional income to mutual companies. The purpose of § 809 was not to tinker with the "policyholder dividend deduction" established in §§ 805 and 808, but rather to create a new formula that would charge mutual life insurance companies for an amount of taxable earnings that could not be identified in their books. The formula took no account of the actual experience of any particular taxpayer company, *and it made no reference to dividends.* Instead, it looked only to industry averages—and averages from different sets of years at that. It compared an earlier three-year average of the earnings rate of stock companies with the rate of return for mutuals in a subsequent year. Subtracting the mutuals from the stocks gave a rate which, multiplied by each mutual company's equity value, was assumed to be the proper adjustment to its taxable income for the later year. This amount depended entirely on multiplying the rate times the size of the company's equity—not on how much it paid that year in dividends to policyholders, indeed, not even on whether it paid or accrued any policyholder dividends at all.

3. The Court of Appeals reasoned that because Congress (correctly) expected that stock rates usually would

exceed mutual rates *in any given year*, therefore Congress must also have intended that the industry comparisons of different periods enacted in the statute would also result in stock-company figures from one period higher than the mutual-company figures for a wholly different period. That is a *non sequitur*. Yet the heart of the Court of Appeals' opinion was its assertion that "whether Congress was right or wrong in its assumption, it expected, *and thus intended*, that 'excess' would be a positive number." P.C.A. 7a (emphasis supplied). The reference to "excess" in § 809(c)(1), the court suggested, implied that the result of subtraction would never be a negative number. That unsupported and acontextual characterization of the word "excess" was as close as the court ever came to any hook in the text for its legislative-intent holding. And such a reading not only is not linguistically plausible, but ignores the context of the statute itself, and makes no economic sense.

4. The Court of Appeals apparently believed that in 1986 something freakish had occurred: that "the operative assumption behind the section 809 formula . . . turned out to be wrong in 1986." P.C.A. 7a. "Neither the recomputed differential earnings rate nor the recomputed differential earnings amount *should* be negative." *Id.* (emphasis supplied.)[21] But the court's factual assumption was mistaken. There was no inversion in 1986. In that year stock company returns on equity, as usual, did exceed those of mutual companies. What made the number negative was that the statute's formula compares average stock company returns on equity from *one period* (here 1983-1985) with mutual company returns from a *later period* (here 1986). Insurance industry returns fluc-

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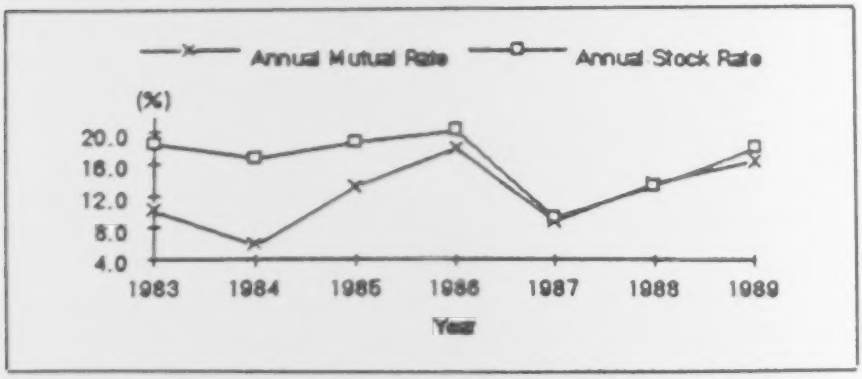
[21] Yet the Government had acknowledged that a negative result was not unusual at all. See Government's Reply Brief at 3; Tr. of Oral Arg. at 2, 9:

"Judge Magill: Is that unusual?

"[Government attorney]: It has not proven to be, Your Honor. . . . The last three out of four years have been negative."

tuate significantly from year to year. The following graph [22] illustrates the industry's ups and downs:



With wide annual fluctuation the norm for the industry, it is not surprising that *in a particular year,* here 1986, mutual returns—although still beneath stock company returns for that year—may exceed average stock company returns *for an earlier three-year period.* Thus negative numbers sometimes occur. They balance out over time.

5. The Court of Appeals decided to downgrade the "life insurance deduction" of § 809 to the status of a trivial delayed adjustment to the "policyholder dividend deduction" of § 808. In spite of the plain statutory formula of § 809(f)(2)—and in spite of the IRS's own prior acknowledgement of negative amounts, see p. 5a, *infra*—the Court of Appeals took the very step the District Court had recognized would be judicially improper. It read § 809(f)(2) as if Congress had added the words, "but the amount of such deduction for the year shall not exceed the differential earnings amount for the preceding taxable year." See P.C.A. 16a.

6. When a court decides to scrap statutory language because of supposed congressional intent, one would expect at least some clear and forceful statement in the legislative history that Congress had wanted to do what the

[22] See Plaintiff-Appellee's Petition for Rehearing, No. 94-1440, U.S.C.A., Eighth Cir., at 7.

court is ordering. But here there is nothing. The congressional committees' reports on § 809 nowhere suggest that the imputation of income is tied to dividends. See H.R. Rep. No. 98-432, 98th Cong., 2d Sess., Pt. II at 1425 (1984); S. Rep. No. 98-169, 98th Cong., 2d Sess. 552 (1984).

7. The fundamental flaw in the Court of Appeals' holding, apart from the fact that it undertakes to rewrite the tax code, is that it is utterly contrary to logic. Under the Court of Appeals' decision, when expectable annual fluctuations result in *increases* in imputed taxable income of mutuals, the mutuals will have to pay taxes on those increased amounts without any upward limit, and without any relation to what their policyholder dividends were in that year. That is required by § 809(f)(1). But in the years when fluctuations *reduce* imputed income, the Court of Appeals would arbitrarily cut off the reduction as soon as it exceeds the amount of policyholder dividends —in spite of the calculation plainly commanded by § 809(f)(2). The Government created a theory, which the court wrote into law, to eliminate only the fluctuations that favor the taxpayer. It amounts to "Heads, I win, tails, we don't count it." That may well be attractive to an energetic revenue collector, but it is disastrous for a taxpayer and an industry. The statute contains no such asymmetry.

B. Contrary to This Court's Decisions, the Court of Appeals Substituted Its Concept of Unstated Congressional Intent for the Statutory Formula.

The statute specifies a formula and a calculation. § 809(f)(2). When that calculation is done as the statute directs, it makes perfect sense that because of annual fluctuations, there will be a negative number in some years. Arbitrarily to treat years with negative numbers as zero makes no sense at all. Most importantly, even if the statutory formula resulted for 1986 in a figure the Court of Appeals could not understand, or incorrectly

viewed as a "windfall," nevertheless the inescapable fact is that that is the way Congress enacted this provision. The Treasury itself, until the present high-stakes litigation, recognized that the statute was designed independently to impute income, not to measure dividends. See DEPARTMENT OF THE TREASURY, FINAL REPORT TO THE CONGRESS ON LIFE INSURANCE TAXATION 25 n.8 (1989).[23]

The Court of Appeals in its policy arguments, as the petition demonstrates, has it all wrong, and ignores that its decision creates a statute that over time will severely harm mutual companies when there are sharp fluctations, but can never help them. But even if the Court of Appeals' policy were wise and sound, its freewheeling method of reconstructing the tax code was not. The District Court was exactly right in its homey observation that "[i]t is for Congress, not the courts, to rewrite statutes." P.C.A. 16a. This Court's decisions of course agree. *E.g., Blount* v. *Rizzi*, 400 U.S. 410, 419 (1971).

C. The Court of Appeals' Deference to a Regulation Issued After Litigation Violates the Rule of *Skidmore* v. *Swift & Co.*

The Court of Appeals also made a ruling on basic administrative law that violates long established doctrine of this Court. The Court of Appeals pointed out that "[a]fter the district court issued its decision, the Internal Revenue Service issued regulations" announcing with retroactive effect that the figure computed under § 809 (f)(3) may not be less than zero. P.C.A. 8a; see 26 C.F.R. § 1.809-9 (1993), p. 6a, *infra*. The court said that this after-the-fact regulation was "entitled to great deference." P.C.A. 8a.

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[23] "The imputation of equity income was described as a limitation on policyholder dividend deductions, but in fact it is an income imputation. If the imputed income exceeds current policyholder dividends, the current reserve deduction is reduced by the excess." *Id.*

Under this Court's precedents such a regulation, which reverses by 180° a previous interpretation several years old, and is announced in the midst of litigation, is entitled to no deference at all. The familiar rule was first set forth in *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944): the weight to be given an interpretive regulation "will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all of those factors which give it power to persuade, if lacking power to control." See also *Mayburg* v. *Secretary of HHS*, 740 F.2d 100, 105-06 (1st Cir. 1984) (Breyer, J.).

By each of those criteria, the Government's after-the-fact regulation, issued nine years after the statute and renouncing its prior position, resoundingly flunks. An agency's "interpretation does not fare well under these standards" when it "contradicts the position which [it] had enunciated at an earlier date, closer to the enactment of the governing statute," and also "lacks support in the plain language of the statute." *EEOC* v. *Arabian American Oil Co.*, 499 U.S. 244, 257-58 (1991), quoting in part *General Elec. Co.* v. *Gilbert*, 429 U.S. 125, 142 (1976). The "changed view" of an agency "does undercut the argument that the regulations are entitled to deference." *North Haven Bd. of Educ.* v. *Bell*, 456 U.S. 512, 523 n.12 (1982). Even when an agency has not, as here, reversed itself, this Court will "reject the administrative interpretation of the statute" that is "inconsistent with the statutory mandate." *SEC* v. *Sloan*, 436 U.S. 103, 118, 119 (1978). The Court of Appeals' "great deference" to a tendentious regulatory backtracking upsets established jurisprudence and should not be allowed to stand.

CONCLUSION

For the reasons stated herein and in the petition, certiorari should be granted.

Respectfully submitted,

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September 20, 1995

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ADDENDA

ADDENDUM A

DEPARTMENT OF JUSTICE

FOR IMMEDIATE RELEASE
THURSDAY, JUNE, 22, 1995

TAX
(202) 616-2765
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TAX ATTORNEY RECEIVED THE JOHN MARSHALL AWARD FOR SAVING TAX PAYERS FIVE BILLION DOLLARS

WASHINGTON, D.C.—David I. Pincus, a reviewer in the Appellate Section of the Tax Division of the Department of Justice, today received the John Marshall Award in the category of Handling of Appeals. Pincus' handling of a life insurance case helped save the U.S. Treasury five billion dollars.

Michael R. Stiles, the United States Attorney for the Eastern District of Pennsylvania cited Pincus for "his dedicated and exceptional efforts in developing the winning theory for the government in its victory in American Mutual Life Insurance Company v. United States." In that case, an appellate court reversed a district court decision.

Named for the fourth Chief Justice of the United States, the John Marshall Award recognizes exceptional achievement by attorneys of the Department of Justice in seven areas, including one for the handling of appeals.

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95-355

ADDENDUM B

INTERNAL REVENUE SERVICE
ANNOUNCEMENT 88-47
1988-12 Int. Rev. Bull. 56

[March 21, 1988]

DIFFERENTIAL EARNINGS RATE FOR MUTUAL LIFE INSURANCE COMPANIES

This announcement concerns the determination under section 809 of the Internal Revenue Code of the "differential earnings rate" for 1987 and the rate that is used to calculate the "recomputed differential earnings amount" for 1986. (The latter rate is referred to herein as the "recomputed differential earnings rate" for 1986.) These rates are used by mutual life insurance companies to calculate their federal income tax liability for taxable years beginning in 1987.

BACKGROUND

Section 809(a) of the Code provides that, in the case of any mutual life insurance company, the amount of the deduction allowable under section 808 for policyholder dividends shall be reduced (but not below zero) by the "differential earnings amount." Any excess of the differential earnings amount over the amount of the deduction allowable under section 808 shall be taken into account as a reduction in the closing balance of reserves under subsections (a) and (b) of section 807. The "differential earnings amount" for any taxable year is the amount equal to the product of (a) the life insurance company's average equity base for the taaxble year multiplied by (b) the "differential earnings rate" for such taxable year. The "differential earnings rate" for the taxable year is the excess of (a) the "imputed earnings rate" for the taxable year over (b) the "average mutual earnings rate"

for the second calendar year preceding the calendar year in which the taxable year begins. The "imputed earnings rate" for any taxable year is the amount that bears the same ratio to 16.5 percent as the "current stock earnings rate" for the taxable year bears to the "base period stock earnings rate."

Section 809(f) of the Code provides that, in the case of any mutual life insurance company, if the "recomputed differential earnings amount" for any taxable year exceeds the differential earnings amount for such taxable year, such excess shall be included in life insurance gross income for the succeeding taxable year. If the differential earnings amount for any taxable year exceeds the recomputed differential earnings amount for such taxable year, such excess shall be allowed as a life insurance deduction for the succeeding taxable year. The "recomputed differential earnings amount" for any taxable year is an amount calculated in the same manner as the differential earnings amount for such taxable year, except that the average mutual earnings rate for the calendar year in which the taxable year begins is substituted for the average mutual earnings rate for the second calendar year preceding the calendar year in which the taxable year begins.

As described above, the differential earnings rate for 1987 and the recomputed differential earnings rate for 1986 affect the income and deductions reported by mutual life insurance companies on their federal income tax returns for the 1987 taxable year.

Data necessary to determine the tentative differential earnings rate for 1987 and the tentative recomputed differential earnings rate for 1986 have been compiled from returns filed by mutual life insurance companies and certain stock life insurance companies. The Internal Revenue Service is currently examining these returns to verify the accuracy of the data reported on these returns. This ex-

amination will not be completed before the March 15, 1988, due date for filing 1987 calendar year returns.

ANNOUNCEMENT OF TENTATIVE RATES

This announcement publishes a tentative determination of the differential earnings rate for 1987 and of the recomputed differential earnings rate for 1986. This announcement also publishes a tentative determination of several rates on which the calculation of the differential earnings rate for 1987 and the recomputed differential earnings rate for 1986 are based. The final determination of these rates is expected to be published before September 1, 1988. The final determination of other rates on which the calculation of the differential earnings rate for 1987 and the recomputed differential earnings rate for 1986 are based was published in Rev. Rul. 87-92, 1987-36 I.R.B. 9.

The tentative determination of the differential earnings rate for 1987 and the tentative determination of the recomputed differential earnings rate for 1986 that are published in this announcement should be used by mutual life insurance companies to calculate the amount of tax liability for taxable years beginning in 1987 (in the case of companies that file returns before an announcement of the final determination of these rates) or to calculate the amount of properly estimated unpaid tax liability for taxable years beginning in 1987 (in the case of companies that are allowed an extension of time to file returns). Companies that file returns before an announcement of the final determination of these rates should file amended returns after the final determination of these rates is announced. Any failure to pay tax for the 1987 taxable year before September 15, 1988, that is attributable to a difference between (a) the tentative determination of the differential earnings rate for 1987 and recomputed differential earnings rate for 1986 and (b) the final determination of these rates will be treated as due to reason-

able cause and will not give rise to any addition to tax under section 6651 of the Code.

The tentative determination of the rates is set forth in Table 1.

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure. See Rev. Rul. 87-138, 1987-52 I.R.B. 17.

Announcement 88-47,

Table 1

Tentative Determination of Rates To Be Used For Taxable Years Beginning in 1987

Differential earnings rate for 1987	3.647
Recomputed differential earnings rate for 1986	−1.700
Imputed earnings rate for 1987	16.782
Current stock earnings rate for 1987	18.533
Stock earnings rate for 1986	20.185
Average mutual earnings rate for 1986	17.985

ADDENDUM C

Treasury Regulation § 1.809-9 (1993),
26 C.F.R. § 1.809-9

Computation of the differential earnings rate and the recomputed differential earnings rate.

(a) *In general.* Neither the differential earnings rate under section 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under section 809(f)(3) may be less than zero.

(b) *Definitions*—(1) *Recomputed differential earnings amount.* The recomputed differential earnings amount, with respect to any taxable year, is the amount equal to the product of—

(i) The life insurance company's average equity base for the taxable year; multiplied by

(ii) The recomputed differential earnings rate for that taxable year.

(2) *Recomputed differential earnings rate.* The recomputed differential earnings rate for any taxable year equals the excess of—

(i) The imputed earnings rate for the taxable year; over

(ii) The average mutual earnings rate for the calendar year in which the taxable year begins.

(c) *Effective date.* The regulations are effective for all taxable years beginning after December 31, 1986.

Michael P. Dolan,
Acting Commissioner of the Treasury.

Approved November 8, 1993

Leslie Samuels,
Assistant Secretary of the Treasury.

[Published in 58 Federal Register 64899, Dec. 10, 1993]

ADDENDUM D

FINAL REPORT
TO THE CONGRESS ON
LIFE INSURANCE COMPANY TAXATION

Department of the Treasury
August 1989
[Pp. 25-26]

* * * *

B. Reasons for Enactment and Design of Section 809

Section 809 was enacted primarily to assure that mutual companies are taxed on a base that is neither greater or less than their economic income.[7] Congress believed that a portion of the policyholder dividends paid by mutual companies is a distribution of corporate earnings to the policyholders as owners. Because stock life insurance companies cannot deduct amounts paid to their shareholders as dividends, Congress thought it appropriate to impute equity income to mutual companies.[8]

To determine the amount of equity income, an imputation mechanism was chosen because there was no means available to segregate and measure directly the ownership return of participating policies. Thus, section 809 oper-

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[7] *See* S. Rep. No. 169, Vol. 1, 98th Cong., 2d Sess. 521 (1984); H.R. Rep. No. 432, Prt. 2, 98th Cong., 2d Sess. 1397 (1984).

[8] The imputation of equity income was described as a limitation on policyholder dividend deductions, but in fact it is an income imputation. If the imputed income exceeds current policyholder dividends, the current reserve deduction is reduced by the excess. Section 809(a)(2).

ates to impute additional income to mutual companies based on a comparison of the returns on equity of the mutual and stock segments of the industry. Congress believed that profit-oriented enterprises generally distribute earnings to their owners in amounts that are proportional to the owners' equity in the business and, thus, determined that the equity earnings can be measured as a percentage of mutual company equity. Congress also believed that mutual and stock companies in the same industry will earn comparable rates of return on equity over a period of several years. It observed, however, that the average post-dividend, pre-tax return on equity of mutual companies was lower than that for a comparable group of stock companies. This difference, Congress concluded, was attributable to the tax-deductible distribution by mutual companies of earnings to their policyholders.

Congress therefore determined that the appropriate percentage of mutual company equity was generally equal to the difference between the average earnings rate of all mutual companies and the average of the earnings rates of the 50 largest stock comapnies. Congress believed, however, that the stock earnings rate should be adjusted so that the mutual segment of the industry would bear 55 percent of the aggregate industry tax burden for 1984. This allocation was thought appropriate in light of the historic allocation of the industry's tax burden between the mutual and stock segments, the relative percentages of assets held by the stock and mutual segments of the industry, and the difference in tax treatment at the individual level of mutual company policyholders and stock company shareholders.[9] Historical data on these relationships were presented in the 1988 interim report.

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[9] *See* S. Rep. No. 169, at 549; H.R. Rep. No. 432, at 1423.